

REPORT OF THE DIRECTORS

The directors (the “Directors”) of CNOOC Limited (the “Company”) are pleased to present their report together with the audited financial statements for the year ended 31 December 2003.

Principal Activities and Operating Results

The principal activity of the Company is investment holding of its subsidiaries (which together with the Company shall be known as the “Group”), which are principally engaged in the exploration, development, production and sales of crude oil and natural gas and other petroleum products.

Summary of Financial Information

Please refer to the financial statements for a summary of the assets and liabilities of the Group as at 31 December 2003 on page 54 and the operating results for the year then ended on page 53.

Loans

Please refer to note 26 to the financial statements on pages 84 to 85 for details of the long-term bank loans of the Group for the year ended 31 December 2003.

Property, Plant and Equipment, net

Please refer to note 18 to the financial statements on pages 78 to 79 for movements in property, plant and equipment, net of the Group for the year ended 31 December 2003.

Reserves

Please refer to the statement of changes in equity on page 55 and note 32 to the financial statements on page 91 for movements in the reserves of the Group and the Company, respectively, for the year ended 31 December 2003.

Subsidiaries and Associated Companies

Particulars of the Company’s subsidiaries and associated companies as at 31 December 2003 are set out in notes 19 and 20 to the financial statements on pages 80 to 82.

Dividends

The Directors recommend the payment of a final dividend of HK\$0.12 per share for the year ended 31 December 2003 and a special final dividend of HK\$0.18 per share.

Retirement Benefits

Please refer to note 33 to the financial statements on page 91 to 92 for details of the retirement benefits of the Group for the year ended 31 December 2003.

Major Suppliers and Customers

Purchases from the largest supplier of the Group for the year ended 31 December 2003 represented approximately 13.0% of the Group’s total purchases. The total purchases attributable to the five largest suppliers of the Group accounted for approximately 29.4% of the total purchases of the Group for the year then ended.

Sales to the largest customer for the year ended 31 December 2003 represented approximately 24.8% of the Group’s total oil and gas sales. The total sales attributable to the five largest customers of the Group accounted for approximately 49.2% of the total oil and gas sales of the Group for the year then ended.

None of the Directors or their respective associates (as defined in the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the “Listing Rules”)) or any shareholder of the Company (which to the knowledge of the Directors owns more than 5% of the Company’s share capital) had any interests in the five largest suppliers or customers of the Group for the year ended 31 December 2003.

Connected Transactions

The Independent Non-executive Directors confirmed that the following connected transactions for the year ended 31 December 2003 to which the Group was a party and the agreements governing those transactions were entered into by the Group:

- 1 in the ordinary and usual course of its business;
- 2 either (a) on normal commercial terms, or (b) where there was no available comparison, on terms no less favourable than those available to independent third parties; and
- 3 on terms that were fair and reasonable so far as the shareholders of the Company were concerned.

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The Independent Non-executive Directors further confirmed that:

- 1 the aggregate annual volume of transactions under the materials, utilities and ancillary services supply agreements has not exceeded 10% of the audited consolidated total revenues of the Group in the immediate preceding financial year;
- 2 the aggregate annual volume of transactions in relation to technical services has not exceeded RMB5,853 million;
- 3 the aggregate annual volume of transactions in relation to research and development services for particular projects has not exceeded RMB141 million;
- 4 the aggregate annual volume of transactions in relation to sales of crude oil, condensate oil and liquefied petroleum gas has not exceeded 42% of the audited consolidated total revenues of the Group in the immediate preceding financial year;
- 5 the amount paid under the general research and development services agreement has not exceeded RMB110 million; and
- 6 the aggregate amounts paid under the lease and management agreements have not exceeded RMB78 million.

The auditors of the Group have reviewed the transactions referred to in the above paragraph 1 to paragraph 6 and confirmed to the Directors that:

- 1 the transactions have received the approval of the Directors;
- 2 the transactions were in accordance with the pricing policies as stated in the Company's financial statements; and
- 3 the transactions were entered into in accordance with the terms of the agreements governing the transactions.

Please refer to note 29 to the financial statements on pages 86 to 88 for a summary of the related party transactions which include the Group's connected transactions.

Share Capital

Please refer to note 31 to the financial statements on pages 88 to 90 for details of movements in the Company's share capital for the year ended 31 December 2003.

Issue of Bonds

In May 2003, the Company successfully issued 10-year and 30-year bonds with a total amount of US\$500 million which included US\$200 million 4.125% guaranteed notes due 2013 and US\$300 million 5.50% guaranteed notes due 2033. The Company intends to use the net proceeds of the bond offerings for general corporate purposes.

Share Option Schemes

The Company has adopted share option schemes which provide for the grant of options to the Company's senior management. Under these share option schemes, the remuneration committee of the Company's board of directors will from time to time propose for the board's approval for the recipient of and the number of shares underlying each option. These schemes provide for issuance of options exercisable for shares granted under these schemes as described below not exceeding 10% of the total number of the Company's outstanding shares, excluding shares issued upon exercise of options granted under the schemes from time to time.

On 4 February 2001, the Company adopted a pre-global offering share option scheme (the "Pre-Global Offering Share Option Scheme"). Pursuant to the Pre-Global Offering Share Option Scheme:

- 1 options for an aggregate of 4,620,000 shares have been granted;
- 2 the subscription price per share is HK\$5.95; and
- 3 the period during which an option may be exercised is as follows:
 - (a) 50% of the shares underlying the option shall vest 18 months after the date of the grant; and
 - (b) 50% of the shares underlying the option shall vest 30 months after the date of the grant.

The exercise period for options granted under the Pre-Global Offering Share Option Scheme shall end not later than 10 years from 12 March 2001.

On 4 February 2001, the Company adopted a share option scheme (the “2001 Share Option Scheme”) for the purposes of recognising the contribution that certain individuals had made to the Company and attracting and retaining the best available personnel to the Company.

Pursuant to the 2001 Share Option Scheme:

- 1 options for an aggregate of 8,820,000 shares have been granted;
- 2 the subscription price per share is HK\$6.16; and
- 3 the period during which an option may be exercised is as follows:
 - (a) one-third of the shares underlying the option shall vest on the first anniversary of the date of the grant;
 - (b) one-third of the shares underlying the option shall vest on the second anniversary of the date of the grant; and
 - (c) one-third of the shares underlying the option shall vest on the third anniversary of the date of the grant.

The exercise period for options granted under the 2001 Share Option Scheme shall end not later than 10 years from 27 August 2001.

In view of the amendments to the relevant provisions of the Listing Rules regarding the requirements of share option schemes of a Hong Kong listed company effective on 1 September 2001, no further options will be granted under the 2001 Share Option Scheme.

In June 2002, the Company adopted a new share option scheme (the “2002 Share Option Scheme”).

Under the 2002 Share Option Scheme, the Directors of the Company may, at their discretion, invite employees, including executive directors, of the Company or any of its subsidiaries, to take up options to subscribe for shares. The maximum aggregate number of shares (including those that could be subscribed for under the Pre-Global Offering Share Option Scheme and the 2001 Share Option Scheme) which may be granted shall not exceed 10% of the total issued share capital of the Company. The maximum number of shares which may be

granted under the 2002 Share Option Scheme to any individual in any 12 month period up to the next grant shall not exceed 1% of the total issued share capital of the Company from time to time.

According to the 2002 Share Option Scheme, the consideration payable by a participant for the grant of an option will be HK\$1.00. The subscription price of a share payable by a participant upon the exercise of an option will be determined by the Directors at their discretion at the date of grant, except that such price may not be set below a minimum price which is the highest of:

- 1 the nominal value of a share;
- 2 the average closing price of the shares on the HKSE as stated in the HKSE’s quotation sheets for the five trading days immediately preceding the date of grant of the option; and
- 3 the closing price of the shares on the HKSE as stated in the HKSE’s quotation sheets on the date of grant of the option.

On 24 February 2003, the board of directors approved to grant options in respect of 8,410,000 shares to the Company’s senior management under the 2002 Share Option Scheme. The exercise price for the options is HK\$10.54 per share. The market price was HK\$10.55 per share preceding the options granted. Options granted under the 2002 Share Option Scheme may be exercised, in whole or in part, in accordance with the following vesting schedule:

- 1 one-third of the shares underlying the option shall vest on the first anniversary of the date of the grant;
- 2 one-third of the shares underlying the option shall vest on the second anniversary of the date of the grant; and
- 3 one-third of the shares underlying the option shall vest on the third anniversary of the date of the grant.

The exercise period for options granted under the 2002 Share Option Scheme shall end not later than 10 years from the date on which the option is granted.

As at 31 December 2003, the Directors and others had the following personal interests in options to subscribe for shares in the Company granted under the share option schemes of the Company:

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Name of Grantee	No. of shares involved in the options outstanding at the beginning of the year	No. of shares involved in the options outstanding at year end	Date of Grant	Closing price per share immediately before the date on which the options were granted (HK\$)	Exercise Price (HK\$)
Fu Chengyu	350,000	350,000	12 March 2001	–	5.95
	350,000	350,000	27 Aug 2001	7.30	6.16
	–	230,000	24 Feb 2003	10.45	10.54
Zhou Shouwei	280,000	280,000	12 March 2001	–	5.95
	350,000	350,000	27 Aug 2001	7.30	6.16
	–	350,000	24 Feb 2003	10.45	10.54
Jiang Longsheng	280,000	280,000	12 March 2001	–	5.95
	230,000	230,000	27 Aug 2001	7.30	6.16
	–	230,000	24 Feb 2003	10.45	10.54
Luo Han	280,000	280,000	12 March 2001	–	5.95
	230,000	230,000	27 Aug 2001	7.30	6.16
	–	230,000	24 Feb 2003	10.45	10.54
Others:	3,430,000	3,430,000	12 March 2001	–	5.95
	7,660,000	7,660,000	27 Aug 2001	7.30	6.16
		7,370,000	24 Feb 2003	10.45	10.54

As at 31 December 2003, no options granted under the share option schemes of the Company have been exercised.

The weighted average fair value of the options granted under the Pre-Global Offering Share Option Scheme, the 2001 Share Option Scheme and the 2002 Share Option Scheme at the grant dates was RMB3.40. This was estimated using the Black-Scholes option pricing model under the following assumptions: risk-free interest rates of 5.25%, expected volatility of 44%, an expected life of five years and an expected dividend yield of 2.0%. The assumptions on which the option pricing model is based represent the subjective estimations of the Directors as to the circumstances existing at the time the options were granted.

Purchase, Sale or Redemption of Shares

For the year ended 31 December 2003, neither the Company nor its subsidiaries has purchased, sold or redeemed any of the Company's listed shares.

Substantial Shareholders of the Company

The register maintained by the Company pursuant to the Securities and Futures Ordinance (the "SFO") recorded

that, as at 31 December 2003, the following corporations had interests (as defined in the SFO) in the Company set opposite their respective names:

	Ordinary Shares	Percentage of Total Issued Shares
(i) CNOOC (BVI) Limited ("CNOOC (BVI)")	5,800,000,000	70.61%
(ii) Overseas Oil & Gas Corporation, Limited ("OOGC")	5,800,000,000	70.61%
(iii) China National Offshore Oil Corporation ("CNOOC")	5,800,000,000	70.61%

CNOOC (BVI) is a wholly-owned subsidiary of OOGC, which is a wholly-owned subsidiary of CNOOC.

Accordingly, CNOOC (BVI)'s interests are recorded as the interests of OOGC and CNOOC.

All the interests stated above represent long positions. As at 31 December 2003, no short positions were

recorded in the Register of Interests in Shares and Short Positions required to be kept under section 336 of the SFO.

Directors and Senior Management of the Company

Please refer to pages 36 to 40 for information concerning the Directors and senior management of the Company.

Directors' Interests

As at 31 December 2003, the interests of the Directors and the chief executive of the Company in the equity securities of the Company and its associated corporations (all within the meaning of Part XV of the SFO) as recorded in the register required to be kept under section 352 of the SFO or disclosed in accordance with the Listing Rules are detailed below.

As at 31 December 2003, the Directors had the personal interests in options to subscribe for shares in the Company granted under the share option schemes of the Company as disclosed in this report.

All the interests stated above represent long positions. As at 31 December 2003, no short positions were recorded in the Register of Directors' and Chief Executives' Interests and Short Positions required to be kept under section 352 of the SFO.

Directors' Interests in Contracts

Each of the executive Directors has entered into a service contract with the Company for a term of three years effective from 28 February 2001 and thereafter subject to termination by either party thereto giving not less than three months' written notice. Such contracts may be renewed or extended as appropriate.

Apart from the foregoing, no director proposed for re-election at the forthcoming annual general meeting has an unexpired service contract with the Company which is not determinable by the Company within one year without payment of compensation (other than normal statutory obligations).

No contract of significance to which the Company or any of its subsidiaries was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

Emoluments of the Directors and the Five Highest Paid Individuals

Please refer to notes 12 and 13 to the financial statements on pages 73 to 74 for details of the emoluments of the Directors and the five highest paid individuals of the Company.

Material Legal Proceedings

As at 31 December 2003, the Company was not involved in any material litigation or arbitration and no material litigation or claims was pending or threatened or made against the Company as far as the Company is aware of.

Compliance with the Code of Best Practice

The Company has complied with the Code of Best Practice as set out by the HKSE in Appendix 14 to the Listing Rules throughout the year ended 31 December 2003, except that the Non-executive Directors were not appointed for a specific term, but are subject to retirement by rotation and re-election at the Company's annual general meeting in accordance with the Company's articles of association.

Auditors

Ernst & Young was appointed as the auditors of the Company for the year ended 31 December 2003 and has audited the accompanying financial statements. A resolution to re-appoint Ernst & Young as auditors of the Company will be proposed at the forthcoming annual general meeting.

By Order of the Board

Fu Chengyu

Chairman

Hong Kong, 15 March 2004